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Progress in Europe

Evolution of abus de droit in ECJ

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There is something catchy about the phrase "abus de droit". The possible English translations (abuse of law, abuse of rights, tax avoidance) do not really have the same ring to them. "Abus de droit" just has a certain je ne sais quoi - as the English would say. Perhaps it is this undefined quality which has meant that the term has survived the Halifax case (C-255/02) in the European lexicon. After all, we should not forget that Advocate General Maduro was concerned that the term may be misleading and preferred "prohibition of abuse of Community law" (Halifax para 71). I too see how the term may be misleading (arguably the result of "abuse of rights" applying is that you have no such rights or that you never did in the first place) but just like the Advocate General I intend to continue using it for simplicity's sake.

Tax advisers are sometimes accused of living or at least working in ivory towers locked away from the rest of the world. Either that or we live/work in a legal 'Wild West" or a "fiscal theme park", depending on whether you listen to AG Maduro or Sedgley LJ. In order to disprove the theory that tax advisers live in a world consisting only of tax, let me firstly acknowledge that abus de droit is not unique to tax cases (see for example TV 10 SA C-23/93 and Chen C-200/02). But for tax lawyers the most interesting refinements have naturally come in the tax context, whether it is VAT (Halifax, Part Service C-425/06) or direct tax (Cadbury Schweppes C-196/04).

‘Evolution of abus de droit in ECJ’

Generally a distinction is drawn between abus de droit in VAT and direct tax contexts. The reason that a distinction has developed is not simply that many tax advisers specialise in either direct or indirect tax. It is not even that VAT is a European tax whereas direct tax is the preserve of each member state. The reason for the distinction lies in the questions asked of the ECJ in the two types of cases. In the VAT cases the question is typically whether a particular relief or exemption applies. I include Emsland Starke (C-110/99) as an example of this type of case, as although not concerning VAT, it dealt with an

exemption provided by Community law. In the direct tax cases by contrast, the court is typically asked whether the restrictions imposed on the fundamental freedoms by member states are justified and proportionate.

So whilst to the outside observer both VAT and direct tax cases deal with questions of avoidance, for the ECJ, the questions must seem in many ways to come from opposite ends of the spectrum. In the VAT cases the court is asked whether certain actions of taxpayers are abusive and must assess the alleged abuse against its own principles and formulations of what abuse is. But in the direct tax cases the court is asked whether actions of Member States are proportionate in the context of the fundamental freedoms. It is not obliged to judge the actions of the taxpayer directly. Proportionality and abuse - both rule of law doctrines - are therefore inextricably tied together. Proportionality regulates the state, which may not go further than necessary to restrict the Treaty freedoms. Abuse of law regulates the subject, who cannot rely on the law itself to go further than the purpose envisaged by the legislation. The VAT cases therefore require a much more focused approach to what constitutes abuse, and because of this have arguably produced a clearer formulation of the test for abusive practices.

Until Emsland Starke, the principle of abuse of rights had not clearly been accepted by the ECJ. It had been advanced by certain advocate generals e.g. Darmon, but resisted by others e.g. Tesauro in Kefalas (C-367/96) - a case about a domestic anti-avoidance provision. However, the principle was clearly accepted in Emsland Starke and it is fair to say that it is now enshrined in Community law. Before discussing the evolution of the principle set out in Emsland Starke in the VAT cases, it is worth considering the court's attitude to tax avoidance in direct tax cases.

The court's job is somewhat easier where it is asked to rule on a restriction to the fundamental freedoms imposed by a member state fearful of tax avoidance compared to where it is asked to judge whether the community principle of abus de droit has been infringed. Cases such as M&S (C-446/03) and Cadbury Schweppes have shown that the court will acknowledge that while the fundamental freedoms do grant the rights in principle to engage in abusive transactions, restrictions of those rights are justifiable provided they are proportionate. This acknowledgement that tax avoidance is unacceptable is not very surprising, but the key is what level of avoidance or planning is unacceptable (or to put it in ECJ terminology, what justification is proportionate). This is frequently left to national courts to decide and the legislatures of member states are then asked to have another go at making their legislation compliant.

It is harder for the court to duck the question of what abus de droit means in the VAT cases. Schumacher (C-250/80) and Emsland were cases with similar facts. Both cases examined whether an export refund should be available where the goods in question were immediately re-exported. In both cases the result was the same, but ostensibly for slightly different reasons. In Schumacher the decision was that the right to exemption did not extend to abusive transactions. So no right to the advantage exists at all on those particular facts. Of course this approach still begs the question as to what constitutes abusive behaviour, since it is all very well to know that abuse voids ones rights, but not very satisfactory if one does not know what abuse is.

Academics and practitioners alike are always tempted to draw out general principles from decisions which are necessarily specific to one set of facts. This is an understandable temptation because citizens naturally wish to understand what they can and cannot do under the law. The ECJ recognises the principles of legitimate expectation/legal certainty (see van Es Douane Agenten C-143/93 and Belgium v Commission C-110/03 amongst others) and also recognises that their decisions are binding across a vast area. Perhaps as a result, the court has proved willing at times to set out specific tests which taxpayers can in theory apply to determine whether particular planning is abusive.

In Emsland, the test for abuse was set out as having two elements. Objective - the purpose of the law not achieved and subjective - an intention to obtain an artificial advantage. This is largely the test we still have following Halifax, but the subjective element, although still important, has been recharacterised in objective terms such that in Halifax the test that emerged was

1. Was the result of the steps taken contrary to the purpose of the law? and if so;

2. Was the essential aim of taking the steps to achieve that result?

If that test seems clear on first reading, the cases (both domestic and European) that have followed have shown that there is wide scope for interpretation. A convenient way to approach the Halifax test is to consider what taxpayers might do to fall outside the scope of abus de droit.

It will be apparent from the two part formulation that there are two obvious ways a taxpayer may fall outside this test. The first is if the steps taken do not produce a result contrary to the law. If this is the case then there will be no need to consider the second limb. In general it is probably fair to say that the simpler the planning, the more likely it is that the taxpayer will prevail with this argument. Following steps laid out in the law to take advantage of a relief is likely to be more defensible than a series of interlocking transactions designed to fall into a loophole in overlapping taxing provisions. However, even taking advantage of fairly simple provisions granting relief may not be enough to persuade the court that the result of the steps taken is within the purpose of the law.

In a recent UK case, the court of first instance considered an arrangement to sell land for holiday homes (standard rated) and use a subsidiary to separately supply the associated construction services (zero rated) in order to reduce the VAT that would otherwise have been charged to the individual buyers if they had just bought a developed holiday home. In a judgment heavily influenced by the ECJ's reasoning in Part Service (C-425/06), the first test was found to have been breached on the grounds that the aim of the VAT directive is to achieve fiscal neutrality and that as most developers of holiday homes just sold the completed homes to individuals, this way of splitting the services distorted competition. While no-one would argue that achieving fiscal neutrality is not a purpose of the VAT system, it seems equally reasonable to conclude that built into the VAT system are instances where member states are permitted to remove the effects of VAT from supply chains involving certain types of supply. There is no argument that services of construction did take place, and there is precious little discussion about apportionment of value to these services. So is it fair to conclude that because other sellers typically bundle their sales up with their construction services, that is the benchmark for all such transactions and to do otherwise is contrary to the purpose of the directive? The court in Halifax (para 73) allows for the possibility of taxpayers legitimately minimising their tax liability, but if supplying a holiday home and construction services is seen as being abusive because other suppliers typically characterise it as the supply of a holiday home only, then the scope for minimisation seems very small indeed!

Returning to the two part Halifax test, assuming that the taxpayer fails to convince the court that the result is that envisaged by the law, the argument will focus on "essential aim". The meaning of this phrase has itself been the subject of a reference to the ECJ in Part Service which asked whether "essential aim of which is to obtain a tax advantage" is broader or narrower than "transactions carried out for no commercial reasons other than a tax advantage". The court confirmed that the former is wider than the latter. In other words a transaction carried out for no commercial purpose other than a tax advantage will have as its essential aim the obtaining of a tax advantage, but a transaction whose essential aim is to obtain a tax advantage will not necessarily be a transaction carried out for no commercial purpose. This reference was considered necessary because the reasoning of the court in Halifax (and to an extent Cadbury Schweppes) suggested that while a commercial purpose is required to rebut an argument of tax avoidance, it does not preclude there from being a strong tax motive. This is still the case, but it is even clearer now that where tax avoidance is the main objective of the transaction, having a subsidiary commercial purpose will not be enough to save the planning. One point to note on transactions which aim to secure a number of tax advantages is that where the object of the attack is a particular tax advantage (e.g. VAT), it may be that the motive of obtaining a tax advantage in a different tax (e.g. transfer tax) is sufficiently commercial to mean that the VAT advantage is not the essential aim.

The trend appears to be for domestic courts to use Halifax to take an increasingly harsh line on tax (particularly VAT) avoidance and for the ECJ to increasingly accept combating tax avoidance as a proportional justification for Member States in discrimination cases. Although this might be seen as a negative trend, we at CMS believe that planning possibilities do still exist if the context is right. Taxpayers can perhaps also take heart from the fact that if the abus de droit principle becomes increasingly codified it is likely to lose some of its current flexibility and perhaps an element of certainty will return. So for instance while the guidelines laid down in Part Service appear to strike out a number of possible arrangements, taxpayers can perhaps be more confident that if they fall outside these guidelines they are more likely to receive a favourable hearing.

Finally, no article on abus de droit would be complete without mentioning the possibility of insuring against the risk that a particular transaction is seen as abusive. This type of insurance is commonly available in certain jurisdictions, and we at CMS have considerable experience of acting for insurers offering it.

We would be happy to discuss any of the issues raised above and can put you in contact with insurers specialising in tax risk insurance if required.

Austria

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

Under Austrian tax law, the concept of abuse of law is implemented.

The main provision is Section 22, paragraph 1 of the Federal Tax Procedures Act (*Bundesabgabenordnung*) which provides that the tax liability cannot be avoided or reduced by abuse of forms and means available under civil law. According to prevailing case law, an abuse of law is constituted whenever an unusual and inappropriate legal structure is chosen for the only reason to avoid or reduce taxes. In other words, an abuse of law is constituted when there is no economic reason except tax avoidance for a specific legal structure. According to Section 22, paragraph 2 of the Federal Tax Procedures Act, the tax authorities are entitled in the event of abuse of law to impose the taxes that would have been triggered if an appropriate legal structure had been chosen in relation to the facts of the relevant case and the economic intention of the parties.

Another provision to be mentioned in this context is Section 23, paragraph 1 of the Federal Tax Procedures Act which provides that sham transactions are disregarded for tax purposes. If a sham transaction hides a transaction which in fact is intended by the parties, this so-called hidden transaction is decisive for tax purposes.

Abuse of law in Austria

Furthermore, Section 10, paragraph 4 of the Austrian Corporate Income Tax Act contains an anti-abuse provision regarding dividends and capital gains received from holdings in foreign companies. In general, such dividends and capital gains are exempt from corporate income tax under certain conditions (so-called "international participation exemption"). However, the tax-exemption does not apply in the event of presumed tax avoidance, in particular, where (i) the subsidiary does not operate but focuses on earning passive income (e.g. interest income, rental income, income from royalties) and (ii) the subsidiary's effective tax burden is less than 15%. If both criteria are met, tax avoidance is presumed and the dividends and capital gains are not tax-exempt.

The concept of abuse of law is also reflected in the "substance over form" approach which generally applies under Austrian tax law.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

In practice, the tax authorities increasingly identify transactions that qualify as an abuse of law. During the last five years, significant case law has been developed based on the statutory provisions outlined above (see above 1.) and enlarged by the criterion of substance (see below 3.).

The Supreme Administrative Court has developed an independent legal position regarding abuse of law based on the relevant statutory provisions. However, EU case law is increasingly taken into consideration by the Supreme Administrative Court. For example, in its decision dated 24 July 2007, 2007/14/0029, the Supreme Administrative Court refers to the decision of the European Court of Justice dated 12 September 2006, Rs C-196/04, Cadbury Schweppes.

According to the prevailing opinion, the Austrian Supreme Administrative Court will be challenged to adopt its case law in respect of the anti-abuse provision pursuant to Section 10, paragraph 4 of the Austrian Corporate Income Tax Act (see above 1.) in view of the ECJ's recent case law. In particular, the above-mentioned anti-abuse provision provides for the presumption of tax abuse if two criteria are met. Some commentators adopt the position that further to the ECJ decision dated 12 September 2006, Rs C-196/04, Cadbury Schweppes, that such presumption should be disputable, which is currently not the case (cf. Lang, Rechtsmissbrauch und Gemeinschaftsrecht im Lichte von Halifax und Cadbury Schweppes, SWI 2006, 273).

Furthermore, the Supreme Administrative Court's case law regarding abuse of law is increasingly compared with and reflected against the ECJ's case law in literature (cf. Zorn in Festschrift Doralt (2007), 535 ff, where the decision of the ECJ dated 21 February 2006, Rs C-255/02, Halifax, is reflected against the case law of the Supreme Administrative Court).

The concept of beneficial ownership is implemented under Austrian tax law. Pursuant to Section 24, paragraph 1 of the Federal Tax Procedures Act, assets – and the income derived therefrom – are attributed to the beneficial owner who may deviate from the owner under civil law. For example, in the event of trusteeship, the trustee is usually the owner under civil law but the trustor is the beneficial owner with the consequence that the trust property and the income derived therefrom is attributed to the trustor for tax purposes. The tax authorities and courts take a rather wide view of the meaning of "beneficial ownership".

The concept of beneficial ownership is also contained in Section 2 , paragraph 1 of the Austrian Act on EU Withholding Tax (EU-Quellensteuergesetz, Federal Law Gazette 2004/33) which transposes the EU Savings Directive, 2003/48/EG, into national law. The definition of beneficial ownership contained therein corresponds to the definition laid down in the Directive.

Finally, the concept of beneficial ownership is also implemented in the double taxation treaties concluded by Austria. The definition of beneficial ownership corresponds to the OECD Model Tax Convention.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

The concept of abuse of law is perceived and applies equally in national and international transactions.

Since the so-called "Treaty Shopping Decision I" (Decision of the Supreme Administrative Court dated 10 December 1997, 93/13/0185), it is established under case law that treaty protection is denied in the

event of interposition of companies without substance, e.g. "letter box companies".

In this context, the Supreme Administrative Court's most important recent decisions are as follows:

- Decision of the Supreme Administrative Court dated 9 December 2004, 2002/14/0074 ("Dublin Docks I");
- Decision of the Supreme Administrative Court dated 19 January 2005, 2000/13/0176 ("Hong Kong");
- Decision of the Supreme Administrative Court dated 10 August 2005, 2001/13/0018 ("Dublin Docks II").

The two so-called "Dublin Dock" cases refer to the interposition of financing companies in the International Finance and Service Centre (IFSC) in Ireland by Austrian companies. On the one hand, the interest income received by the Irish subsidiary was tax-exempt or subject to low-tax rates in Ireland, and on the other hand, the dividends distributed by the Irish subsidiary to the Austrian parent company were tax-exempt under Austrian tax law. While the German Federal Court of Justice accepts such a legal structure for German tax purposes (cf. Decisions of the German Federal Court of Justice dated 19 January 2000, I R 94/97 and I R 117/97), the Austrian Supreme Administrative Court qualified it as an abuse of law pursuant to Section 22 , paragraph 1 of the Austrian Federal Tax Procedures Act because the Irish subsidiaries did not have notable substance (e.g. own offices and employees). As a result, the Irish subsidiary was treated transparently for tax purposes and its interest income was allocated to the Austrian parent company leading to significant tax payments.

The so-called Hong Kong decision related to the formation of a holding company with poor substance in a low-tax country. The holding company received passive income (interest income) which was tax-exempt in the resident state and forwarded its profits by way of dividends to the Austrian parent company where the dividends were also tax-exempt on the basis of the international participation exemption. The Austrian Supreme Administrative Court ruled that a structure involving a holding company with no or poor substance qualifies as an abuse of law. As a result, the interest income of the foreign holding company was attributed to the Austrian parent company and became subject to Austrian corporate income tax.

Similarly, the formation of a financing company in Jersey with poor substance qualified as abuse of law pursuant and the income of the foreign financing company was attributed to the Austrian parent company (decision dated 22 September 2005, 2001/14/0188).

In sum, the criterion of substance becomes increasingly important in an international context.

4. What penalties/sanctions apply? What defences are available to taxpayers?

First, if a transaction is considered abusive, the tax authority will assess those taxes which would have been payable if a non-abusive structure had been implemented.

Second, the tax authorities will claim (i) a penalty for late payment amounting to 2% of the tax to be paid (Section 217, paragraph 2 of the Federal Tax Procedures Act) and (ii) interest for late payment corresponding to the Austrian base interest rate (Basiszinssatz) plus 2% (Section 205 , paragraph 2 of the Federal Tax Procedures Act).

From a procedural perspective, the taxpayer may appeal against the first instance decision considering a transaction to be abusive within one month following delivery of the first instance decision. The court of first instance may revise its decision or dismiss the appeal. If the appeal is dismissed, the taxpayer may bring the case before the court of second instance. In the event where the appeal is also dismissed in the second instance, the taxpayer may file a complaint with the Supreme Courts, i.e. the Supreme Constitutional Court and/or the Supreme Administrative Court, within six weeks following delivery of the second instance decision.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The concept of abuse of law is increasingly applied by Austrian tax authorities, in particular, in the context of international transactions.

Criminal prosecution usually follows. In the event of intentional tax evasion concerning an amount of evaded taxes exceeding EUR 75,000, the courts have jurisdiction. In all other cases, the tax authorities are responsible for the criminal prosecution. The Austrian Tax Criminal Code provides for several cases, e.g. intentional tax evasion pursuant to Section 33 of the Austrian Tax Criminal Code (Steuerhinterziehung). The range of punishment is up to three times the amount of evaded taxes.

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Belgium

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

Belgian law does not lay down any provisions relating to abuse of law as such.

However, the tax authorities are authorised to dismiss the legal qualification given by the taxpayer to an act when it can be established that such qualification is intended to avoid tax. In this respect, it is provided that the legal qualification given by the parties to an act or separate acts relating to the same transaction is not binding on the direct tax authorities, when the tax authorities can demonstrate that it is intended to avoid tax, unless the taxpayer is able to prove that it corresponds to legitimate financial or economic needs.

The tax authorities' application of this provision is consequently relatively restricted.

In order to be effective, this provision implies that:

- the requalification applied by the tax authorities observes the legal effects of the re-qualified act;
- the act can consequently be classified in several ways.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

The concept of beneficial ownership mainly relates to dividends, interest and royalties and plays a major role in the application of Articles 10 to 12 of international conventions (relating to the state of origin of dividends, interest and royalties), which only grant a reduction or exemption on the withholding at source if the beneficiary established in another

contracting state is also the beneficial owner of the revenue.

However, it is difficult to provide a precise definition of this concept. The interpretations of this concept are divided into two groups: (i) advocates of a wide and economic interpretation on the one hand and (ii) advocates of a strict and legal interpretation on the other hand. The two interpretations clearly feature in international case law.

Application of this concept is not very clear in Belgium in spite of the insertion of Article 27 into its model tax convention which is drafted as follows: "Notwithstanding the provisions of any other provision of this Convention, a resident of a contracting State may not benefit from tax reductions or exemptions provided for by the other contracting state if the main objective or one of the main objectives of this resident or a person related to this resident is to obtain benefits under the Convention". In any event, it appears that checking the beneficial owner is not a prime concern for the tax authorities.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

The Belgian tax authorities do not challenge the interposition of foreign companies, which benefit from a preferential tax regime, on the grounds of an abuse of law. However, lack of substance – or inadequate substance (which does not correspond to the activity deemed to be carried out) – of a foreign company may establish that the effective place of management is located in Belgium and/or that the company is fictitious.

This consequently enables the Belgian tax authorities to tax the entity on its total revenue.

Furthermore, some transactions, such as contributions or sales of assets (shares, bonds, receivables, patents, etc.) to foreign residents who benefit from a preferential tax regime may not be binding on the Belgian tax authorities. The taxpayer shall consequently continue to be liable for taxation on revenue from such assets as though they had not been transferred.

4. What penalties/sanctions apply? What defences are available to taxpayers?

No specific penalties apply. Penalties under ordinary law may be applied: 50% tax increase for a first offence where the taxpayer intended to avoid taxation (as opposed to 10% for a first offence where the taxpayer did not intend to avoid taxation).

A taxpayer may attempt to foil the reclassification applied by the tax authorities by establishing that the proposed classification corresponds to legitimate financial or economic needs. Therefore, it is necessary that such qualification does not solely or mainly result from the taxpayer's wish to avoid tax.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The tax authorities rely on the abuse of law provision to combat relatively complex transactions. However, as the conditions relating to application of this provision are relatively strict, the authorities' attempts are rarely successful.

Criminal penalties are not in theory applicable in relation to the legal reclassification of some acts. Moreover, if criminally reprehensible acts were committed in order to avoid taxation and/or facilitate tax avoidance, it is not necessary to apply this provision to combat such fraudulent mechanisms.

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Bulgaria

Abuse of law in Bulgaria

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

The concept of "abuse of law" exists in the Bulgarian tax system. It is generally a means of combating tax avoidance or evasion and it takes the form of rules authorising the tax authorities to redefine transactions which result in avoidance or underpayment of taxes.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

The concept is implemented through a set of express statutory provisions intended to prevent tax avoidance and evasion. These provisions generally deal with fictitious and hidden transactions, artificial or abnormal structures and transactions not conforming to the economic realities.

Is EU case law taken into consideration in any way?

EU case law is considered in the legislative process of amending the applicable tax laws in order to comply with EU tax law. The courts are gradually developing a practice of referring to EU case law to solve domestic cases, although still not specifically in relation to the abuse of tax laws.

Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

Bulgarian tax law does not currently explicitly provide for the concept of "beneficial ownership". The general provisions for prevention of tax avoidance contain a latent possibility for the tax authorities to enforce this concept especially in cases of artificial structures and fictitious or hidden transactions.

Newer tax treaties concluded by Bulgaria include beneficial ownership as a precondition for treaty entitlement. However, it is an established practice for the tax authorities and respectively the courts to grant treaty benefits to persons who provide evidence of their residence in another contracting state and declare that they are the owners of the respective income.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

The concept "abuse of law" is perceived and the respective provisions implementing this concept are applied equally in domestic and international situations. However, a Bulgarian permanent establishment's transactions with other parts of the company abroad are subject to stricter regulations and administrative scrutiny. Special rules apply to the deductibility of costs and expenses incurred as a result of such transactions.

Bulgarian tax law adopts the "substance-over-form" approach in countering tax avoidance and evasion. The tax authorities and the courts employ this approach to evaluate transactions between related or unrelated parties in both domestic and international contexts.

The tax authorities may redefine or disregard entire transactions (also series of transactions) or their legal form, separate contractual terms and conditions, and determine the taxable income and the respective tax liability based on usual business practices and economic realities.

4. What penalties/sanctions apply? What defences are available to taxpayers?

Bulgarian law provides for fines (fixed as a lump-sum or as a percentage of the avoided/evaded taxes), seizure of property and imprisonment as penalties for abuse of tax law, tax avoidance or evasion.

What defences are available to the taxpayers?

Taxpayers may appeal against acts, decisions, actions or inactions by the tax authorities to a higher tax authority (i.e. the director of the respective local tax office). The higher tax authority may confirm or revoke the appealed acts or adopt new ones. Appeals against acts by the higher tax authority may be lodged before the respective courts. Completion of the administrative appeal procedure is a prerequisite for filing a claim with the court.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The lack of set rules and case law, combined with the general wording of the anti-avoidance provisions, provide the tax authorities with wide discretion regarding the application of the "abuse of law" concept and the corresponding anti-avoidance and anti-evasion provisions.

Circumvention or abuse of Bulgarian tax law may result in criminal charges being brought against the offender. The penalties are imprisonment and fines or seizure of property and vary depending on the amount of underpaid/evaded taxes.

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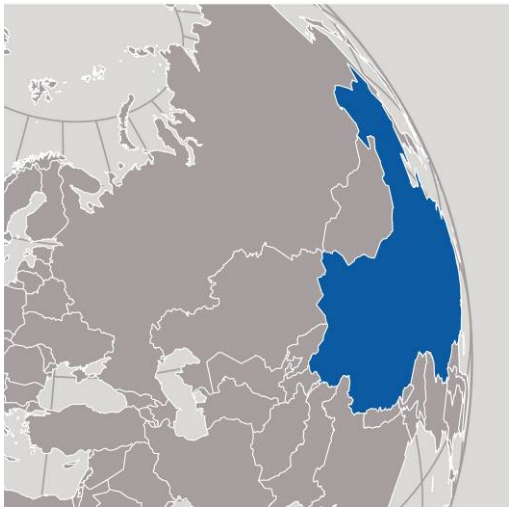

China

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

Under Chinese tax laws and regulations, there is no systematic definition of "abuse of law". However, this term exists in tax regulations and circulars.

Article 47 of the Chinese Corporate Income Tax Law, which came into force on 1 January 2008, provides that "in the event of an arrangement without a reasonable commercial purpose which decreases taxable revenue or income, the tax authorities have the right to make adjustments by applying a reasonable method". Such "arrangement without a reasonable commercial purpose" may be interpreted as an "abuse of law" in China.

We note that the "Implementing Measures of Special Tax Adjustments" (the "Measures"), promulgated on 9 January 2009 and retroactively effective as of 1 January 2008, (new transfer pricing regulations in China), stipulate general tax avoidance rules in Chapter 10, whereby the above "arrangement without a reasonable commercial purpose" is defined as follows:

- "abuse of preferential tax treatments";
- "abuse of tax treaties";
- "abuse of organizational structures";
- "use of tax havens for tax avoidance purposes"; and
- "other arrangements without a reasonable commercial purpose".

Abuse of law in China

In addition, the term "abuse" also appears in many tax circulars relating to the interpretation and implementation of tax treaties for the avoidance of double taxation, where the wording "abuse of tax treaty" is stipulated. For example:

- tax circular relating to the interpretation of the tax treaty between Singapore and China (Article 8) effective as of 6 December 2007 (Guo Shui Han 2007 No.1212);

- tax circular relating to the interpretation of the tax arrangement between Mainland China and Hong Kong (Article 13) effective as of 4 April 2007 (Guo Shui Han 2007 No.403);

- tax circular relating to the interpretation of the tax treaty between the USA and China (Article 2) effective as of 1 January 1987 (86 Cai Shui Xie Zi No.33).

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

This concept was only previously laid down in circulars relating to tax treaties and has been only recently stipulated in the Measures. EU case law is not taken into consideration.

In China, there is no explicit definition of "beneficial ownership".

Chinese Corporate Income Tax Law and its Implementing Regulation, effective as of 1 January 2008, provide for a new legal expression referred to as "actual management institution", which refers to an "institution that conducts substantial and all-round management and control with respect to the production, operations, personnel, finance, property, etc. of the enterprise". An actual management institution shall be also considered as a Chinese tax resident and taxed in China even if the company which established such actual management institution is established outside of China. The "actual management institution" may be similar to the notion of "beneficial owner".

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

There is no clear general concept of substance under Chinese tax laws and regulations.

Article 93 of the Measures provides that "when evaluating whether an enterprise is involved in tax avoidance, the tax authorities shall investigate carefully the "substance" of the enterprise instead of its form in appearance." However, such "substance" is not further explained by Chinese law. Article 94 also states that in the absence of "commercial substance" of a company, especially companies established in tax havens, the tax authorities have the right to deny the existence of this company.

Chinese tax regulations usually adopt the term "reasonable commercial purpose" and "commercial substance". However, there is no clear interpretation or explanation regarding the meaning of these terms.

However, we note that the concept of "substance" is stipulated in Article 1 of the second protocol to the tax treaty between South Korea and China where "90% or more of the income which is subject to a lower tax is completely sourced from active trade or business operations other than investment" is considered by the tax authorities as "substance". However, we do not find any similar provisions in other tax treaties.

4. What penalties/sanctions apply? What defences are available to taxpayers?

According to the Measures, in the event of breach of the "arm's length principle", including Chapter 10, the following penalties may apply:

1. adjustment of the tax payable according to tax authorities' decision;

2. payment of interest for the tax which is levied due to the tax adjustment.

Article 94 of the Measures further stipulates that tax authorities have the right to reassess the taxpayer's tax avoidance arrangement from the commercial substantial point of view in order to eliminate the benefits obtained from such tax avoidance arrangement. For any enterprise which does not have commercial substance, especially enterprises established in tax havens for the purpose of tax avoidance, the tax authorities have the right to deny the existence of this enterprise.

According to the tax treaty between South Korea and China, the legal consequence of the abuse of treaty is the non-application of the tax treaty.

Taxpayers shall be required to provide necessary evidence to prove that their structuring has a reasonable commercial purpose or has "substance" (if any).

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The concept of "abuse of law " is now starting to be used and recognised by the Chinese tax authorities, especially with regard to the tax circular (Guo Shui Han 2008 No.1076).

Apart from the concept of "abuse of law", the Chinese tax authorities are more familiar with the term "tax avoidance", which means that taxpayers take measures to avoid paying taxes or reduce the amount of tax liability by using legal means. Some legal advisors also refer to it as "tax savings". However, some tax authorities consider that tax avoidance is a neutral expression and should consequently also include "tax fraud", which signifies avoidance of taxes or attempt to reduce payable taxes by illegal means. Up till now, there is no clear conclusion regarding the expression "tax avoidance" in China.

We consider that this term overlaps with "abuse of law". Tax avoidance by legal means is not regarded as a breach of criminal law, unless approaches taken for the purpose of tax avoidance are considered as tax fraud by the tax authorities where criminal law applies. Therefore, we consider that the concept of "abuse of law" by legal means is not considered as in breach of criminal law.

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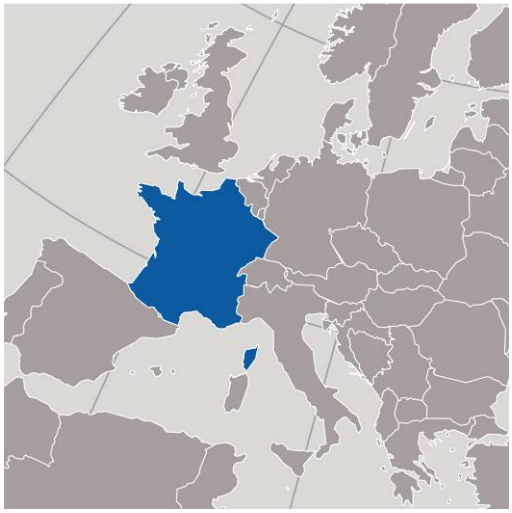

France

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

The concept of abuse of law originated from case law and is based on the adaptation of the concept of fraudulent evasion of the law to tax matters. The concept was added to the General Tax Code a long time ago but it has recently been amended. This amendment was based on the need, firstly, to take into account EU law and, secondly, to fully include the case law concept of fraudulent evasion of the law in the provisions relating to the specific procedure on combating abuse of law in tax matters.

This specific procedure now applies to fictitious acts or acts, which "are aimed at benefiting from a literal application of the provisions or rulings contrary to the objectives sought by their authors, are not inspired by any grounds other than avoiding or minimizing the tax liability which the interested party would normally have to pay based on its actual situation or activities if such acts had not been conducted or implemented."

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

Abuse of law in relation to tax matters was initially defined by the law in a very restrictive manner. However, the Conseil d'Etat's case law has significantly extended the scope of this concept.

In this respect, whereas the original provisions only related to acts concealing the actual scope of a contract or an agreement with a view to avoiding some taxes which where exhaustively listed, case law has extended the scope of abuse of law to:

- acts which are not based on any grounds other than minimising or avoiding the taxes which the taxpayer would normally have to pay,

Abuse of law in France

- and acts enabling all forms of taxes to be avoided or minimized (consequently even taxes which are not referred to by the provisions on abuse of law) where the taxpayer has sought to benefit from a literal application of the provisions contrary to the objectives sought by their authors.

The current legal definition (cf. question 1) incorporates all case law on this matter.

French courts apply EU case law relating to abuse of law (in particular, based on the definition of this concept under EU law; cf. Conseil d'Etat's ruling of 18 May 2005, no. 267087, French tax authorities vs. Sté Sagal).

The notion of beneficial ownership is included in the majority of tax treaties concluded by France. However, the tax treaties recently concluded by France also contain a very strict anti-abuse provision, which goes beyond the traditional clause relating to beneficial ownership, based on the model introduced in the French-UK tax treaty signed on 19 June 2008 in relation to dividends: "The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of this Article by means of that creation or assignment".

The Conseil d'Etat seems to adopt a principle of interpreting beneficial ownership clauses, which apply even when the tax treaty does not contain any specific clauses in this respect. However, it interprets this concept restrictively and the judge only rejects treaty benefits on these grounds in cases where this notion is combined with the case law concept of abuse of fraudulent evasion of the law in tax matters (cf. ruling relating to the Bank of Scotland of 29 December 2006).

The tax authorities are hardly forthcoming regarding the issue and observe OECD's principles in this respect.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

In two much commented rulings handed down relating to structuring international transactions using Luxembourg companies, the Pléiade ruling of 18 February 2004 and the Sagal ruling of 18 May 2005, the Conseil d'Etat ruled that a company cannot be formed solely for tax purposes, where it lacks substance corresponding to the economic reality: no technical expertise, no independent management, etc. More precisely, the Conseil d'Etat noted in the first ruling that:

- the Luxembourg company in question was not the source of economic benefits (the financial investments were not carried out at a lower cost or with a higher profitability rate than the average rates recorded on the French market during the years in question),

- it lacked substance (no technical expertise relating to financial investments, company's total dependence on the bank which formed it),

- the rate of the holding was fixed at a level which was only justified by tax optimisation objectives (ranging between the respective thresholds for application of the parent-subsidiary regime and the anti-tax evasion regime at 25% defined at the time by Article 209 B of the General Tax Code).

4. What penalties/sanctions apply? What defences are available to taxpayers?

A fixed penalty of 80% of the taxes payable by the taxpayer is levied in the event where it is established that said taxpayer was the main initiator or main beneficiary of the abusive acts. Where this is not the case, the penalty amounts to 40%.

A taxpayer who denies having committed an abuse of law may refer the dispute to the Committee on Abuse of Law in Tax Matters, which is chaired by a Conseil d'Etat's judge and comprised of independent persons (judges, lawyers, accountants, notaries, university lecturers, etc.) and hears the two parties. In practice, the tax authorities almost always follow this Committee's opinions.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

In practice, the tax authorities are occasionally tempted to use the threat of abuse of law to ensure that back taxes are accepted when the grounds for such back taxes are uncertain. Criminal sanctions may also be applied but in rather rare cases.

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Germany

Abuse of law

1. Is there a so-called concept of “abuse of law” in your case law/tax system?

Yes.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

The concept of "abuse of law" is laid down by Section 42 of the German Tax Code. The regulations are stricter since 1January 2008 and stipulate that an abuse in this respect involves treatment of the case in a legally inappropriate way leading to a tax benefit, which is not provided for by the German tax authorities or the legislator.

Furthermore, the concept has also been implemented in several specific regulations, e.g. Section 7 of the Foreign Transaction Tax Act, to tax a domestic taxpayer’s income deriving from a shareholding in a foreign company under certain circumstances.

EU case law generally has to be taken in consideration.

The question whether beneficial ownership has to be taken into consideration is not discussed in this context.

‘ Abuse of law in Germany ’

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

A possible application of the criteria of abuse of law is the requirement of substance of an interposed company located abroad leading to reduced taxation. The German tax authorities require economic or other substantial reasons for the interposition. Furthermore, the European Court of Justice's decision concerning cross-border structuring is taken into account. An abuse of law is generally assumed if, for example, the company conducts no economic activity.

4. What penalties/sanctions apply? What defences are available to taxpayers?

In the event of an abuse of the options provided for by German law, tax liability occurs as if the action has been accomplished lawfully.

The taxpayer can produce proof of reasons for the chosen structure, beyond tax reasons, to avoid the application of the regulation. As regards the question of "substance" of a foreign company, the taxpayer can provide proof of compliance with the requirements, e.g. having an office, employees, etc.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The tax authorities deal rather strictly with the requirements especially if tax havens are involved.

Abuse of law as such is generally not a criminal offence. However, tax fraud or tax evasion may be presumed if the taxpayer provides incorrect or incomplete information to conceal an abuse of law.

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Hungary

Abuse of law in Hungary

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

Hungarian tax legislation generally recognises the doctrine of abuse of law. This doctrine is expressly stated in Article 2 of Act XCII of 2003 on the Taxation Procedures of the Republic of Hungary ("Tax Procedures Act"). According to such Article 2:

"(1) All rights in tax-related matters shall be exercised within their meaning and intent. In the application of tax laws, contracts and other transactions concluded with the aim of circumventing the provisions of tax laws shall not be regarded as being exercised within the specific intent of such laws.

(2) In the cases set forth in paragraph (1), the tax authorities shall establish the tax liability considering all circumstances, in particular the tax liability that would have applied if rights were exercised within their meaning and intent or, if the tax base cannot be established in this fashion, by estimation."

This "abuse of law" doctrine is supported by the "substance over form" principle, which is also included in the Tax Procedures Act, and according to which "Contracts, transactions and other similar acts must be characterized based on their real substance".

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

When applied in practice (as is also evident from the official reasoning of these rules laid down by the Hungarian Government), the "abuse of law" doctrine is understood to apply to transactions whose only aim is to achieve a tax benefit. This is clearly a narrower application than what the literal interpretation of the above rules would suggest. Nonetheless, in practice, the "substance over form" principle is applied more widely, resulting in the re-characterization of a transaction where – apart from the aim to save taxes – one or more genuine business reasons might also be present (e.g. re-

characterization of a lease plus service agreement for the provision of manpower).

Often, the "abuse of law" doctrine is only invoked by the courts as an accessory provision, to justify their right to examine the aim or intention of a rule, instead of its wording only. In this way, it is easier for the courts to explain why they consider the taxpayer's conduct to be in breach of the tax provisions. This is very often the case where the taxpayer abuses tax provisions which give rise to an exemption. In such cases, the courts often express that exemptions may not be used to achieve tax benefits which were never intended by the legislator.

In other cases, the "abuse of law" doctrine is used more directly to resolve sham transactions. Examples include disregarding a conduit entity for VAT purposes, where it was evident from objective circumstances (such as the place of registered office, the owners, sales price, etc.) that the interposition of such entity in a transaction involving the supply of goods was exclusively done to achieve tax benefits. In another judgment handed down by the Hungarian Supreme Court, both the tax authorities and the courts found excessive pricing (up to 8-12 times the fair market price) even between unrelated parties to amount to "unreasonable business practices" and considered it abusive.

EU case law is usually not invoked in cases where the "abuse of law" doctrine is applied. One reason could be that the Hungarian abuse of law doctrine is vaguely reminiscent of similar concepts which have been applied for a long time, especially in civil law. For this reason, the Hungarian courts are fairly confident in applying this doctrine, while, at the same time – as explained – they prefer a narrow interpretation and thus remain within the scope generally required by EU law. One field where we have nonetheless seen examples of references to ECJ decisions in particular is in the assessment of "carousel-fraud"-type chain-transactions. In this case, the Hungarian Supreme Court confirmed that even in the case of invoices which fulfil all formal requirements, the tax authorities may nonetheless look at the supplies made before or after the supply under scrutiny, and may require that the origin of the goods is sufficiently proven, particularly if the transactions may reasonably be suspected to constitute a sham.

The concept of "beneficial ownership" (in a tax context) is not really defined by Hungarian domestic law. Until 2001, a definition for corporate income tax purposes (but only with regard to the application of double tax treaties) did exist, but this was repealed due to it "having a generally accepted definition in international practice". The previous Hungarian definition actually more resembled a "subject to tax" clause, i.e. a beneficial owner was someone who booked and declared, for tax purposes, the relevant (e.g. interest) income in its country of residence. Today, the only definition of the beneficial owner is for the purpose of the application of the EU Savings Directive, and reflects the definition set forth in the Directive. Otherwise, we are not aware of any common interpretation which was provided by case law or that this was ever attempted. Hence, "beneficial owner" is usually understood to have the same meaning as included in the various OECD documents, most notably the Commentary on the OECD Model Tax Convention.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

We know of very few cases where the "abuse of law" doctrine was applied to an international setting, and many of them are in one way or another related to "carousel-fraud", or similar VAT-related sham transactions. However, we are aware of one occasion where the tax authorities questioned the economic activity of a holding company, stating that acting as a holding company (in the absence of any other activities, such as the managing of its portfolio of several subsidiaries, etc.) does not, per se, amount to an economic activity.

This interpretation was not reinforced by other similar cases, and we do not know whether this particular case was ever brought before the Hungarian courts (and if so, their decision). However, this shows, in any case, the potential ways in which existing Hungarian tax rules and regulations may, in extreme cases, be interpreted, and warns both advisors and investors to pay attention to creating enough "substance" even in holding companies.

4. What penalties/sanctions apply? What defences are available to taxpayers?

Normally, if a transaction or a series of transactions are considered abusive, the tax authorities would assess those taxes which would have been payable, had the abuse (sham) not occurred. Normally, the most severe sanction (apart from having to pay the unpaid amount of taxes) is the tax penalty, which usually amounts to 50% of the unpaid taxes. However, a 75% tax penalty applies where the underpayment of taxes was accompanied by concealment of income, or the falsification or destruction of books, records, invoices, etc. In addition to the tax penalty, late payment interest is levied up to a maximum of three years. Late payment interest is calculated on the full amount of unpaid taxes and equals twice the Hungarian National Bank's official base interest rate. Such base rate being around 10% during recent years, late payment interest could be a substantial burden as well. In the case of breaching procedural requirements (e.g. failing to declare taxes), a default penalty is also levied, which is much lower.

As described above, the "abuse of law" doctrine generally supposes that the only aim of the transaction (or a series of transactions) was to avoid tax payment obligations. Hence, generally, the primary defence would usually be to stress the economic rationale behind the taxpayer's acts. From a procedural standpoint, an appeal is generally available against the tax authorities' first instance decision, however, in practice, the second instance decision only rarely deviates from the first instance decision. The second instance decision may be challenged before the competent county (or metropolitan) court, whose decision is in principle final. However, in practice, an "extraordinary" request for supervision may be brought before the Hungarian Supreme Court. While it is called "extraordinary", in practice, the procedural rules are lenient enough to allow for supervision in almost all cases. In fact, taxpayers who consider their rights to have been seriously infringed should be prepared to take the case all the way to the Supreme Court. One should bear in mind, though, that the tax authorities tend to win around 90-92% of all cases that are brought before the various Hungarian courts.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The concept of "abuse of law" is increasingly more frequently used by the Hungarian tax authorities. This development is strengthened by the poor state of the Hungarian State budget, and the need to clamp down on leakage of tax income. There is also a bill currently pending before the Hungarian Parliament which aims to close down several loopholes in tax laws, which have existed for years and which made various offshore-type structures very easy to set up and maintain.

Criminal law may also, in some cases be invoked. Theoretically, an act could be prosecuted on the grounds of "tax fraud" whenever "any deceptive conduct" results in a shortfall in the State's tax income. This would, in theory, allow for a very wide interpretation of the concept of "tax fraud" and could potentially result in many cases ending up before the criminal courts. However, in practice, only a minority of sham or otherwise abusive tax-related transactions are prosecuted, most of which relate to concealment of income or falsification of various documents.

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Italy

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

Italian tax law does not contain a general anti-avoidance provision. However, on the basis of Article 37-bis of Presidential Decree No. 600/1973, Italian tax authorities may disregard the tax effects of a combined set of acts, facts and transactions, when they have no sound business purpose, they are carried out to circumvent obligations or prohibitions stated by tax law and to obtain undue tax savings. Acts, facts or transactions covered by this anti-avoidance rule have to fall within a list set forth in the law itself (such list includes M&A transactions, the sale of participations or credits, payments of interest, etc.).

The abuse of law concept as a general anti-avoidance provision has been developed by the Italian courts.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

Abuse of law in Italy

The Italian Supreme Court has recently expressed the view that any act and/or operation carried out by the taxpayer with the main objective of obtaining a tax advantage is considered as an "abuse of law". According to the Supreme Court, such abuse is contrary to the fundamental duties laid down by the Italian Constitution and enables any advantage obtained by the taxpayer to be disregarded (see, inter alia, Decisions No. 8772 of April 4, 2008; No. 10257 of April 21, 2008; No. 25374 of October 17, 2008; No. 30057 of December 23, 2008).

This view represents a development of some of the opinions already expressed by the Supreme Court in the past on dividend washing operations (see, inter alia, Decision No. 20398 of April 29, 2005). This dividend washing operation was concluded between an investment fund (acting as the initial seller and

final purchaser) and an industrial company (acting as initial purchaser and final seller); the initial sale and the final sale were concluded on the same day and executed on the next day and when the two sales were concluded, the resolution relating to the dividends was already adopted. As a result of the operation, the industrial company obtained a dividend (together with the relevant tax credit) and a capital loss, the relevant amounts being almost equal. In summary, the Supreme Court has stated that the two sales have to be considered together as a single operation and that the operation as a whole has to be considered null and void since it has no economic or social objective (therefore, there is no need to assess whether there was an interposition of a person and whether such interposition was fictitious or factual). In this respect, see also the subsequent decisions of the Supreme Court No. 20816 of May 12, 2005, and No. 22932 of October 25, 2005.

Moreover, it has been pointed out that, as a result of the above, the taxpayer's behaviour is always questionable, i.e. whether or not it falls within the scope of a specific anti-avoidance provision, irrespective of the type of transaction/structure under scrutiny, regardless of the type of tax in question.

According to the Supreme Court, an "abuse of law" may be charged by the courts at any stage in the judicial proceedings even if not expressly challenged by the tax authorities.

Is EU case law taken into consideration in any way?

In the past, some judges sitting on the Italian Supreme Court argued that the VAT abuse of law doctrine, as defined by the ECJ in its Halifax judgment (C-255/02), should be considered as an hermeneutic criterion for the entire tax system and thus also be extended to direct tax (see the decisions of the Supreme Court No. 20816 of May 12, 2005; No. 22932 of October 25, 2005; and No. 21221 of September 26, 2006).

As from the above-mentioned Supreme Court judgement issued in December 2008, it seems that the Court's new approach is that the abuse of law doctrine is based on the fundamental duties prescribed by the Italian Constitution, such as the ability to pay tax principle (No. 30055, 30056 and 30057 of December 23, 2008). This approach seems to be confirmed by more recent case law by the Supreme Court (No. 1465 of January 21, 2009, No. 8487 of April 8, 2009, No. 10981 of May 13, 2009, No. 12042 of May 25, 2009).

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

The judicial doctrine of the abuse of law is certainly applicable to domestic as well as to international situations. A more aggressive approach by the Italian tax authorities and courts has been experienced in cases where tax haven companies are involved or where cross-border tax arbitrage transactions occurred.

4. What penalties/sanctions apply? What defences are available to taxpayers?

Although the issue of whether penalties are applicable in the event of abuse of law is very controversial (also in light of ECJ case law), it is important to note that the Italian Supreme Court in its judgement No. 12042 of May 25, 2009 holds that penalties are not to be applied in the event of abuse of law because of the existence of objective conditions of uncertainty regarding the scope of such a general principle.

What defences are available to the taxpayers?

Obviously, the key defence argument for taxpayers is to demonstrate that the transactions at stake have a sound business purpose. In addition, based on the above comments about penalties, taxpayers might ask the Court not to apply penalties because of the existence of objective conditions regarding the uncertainty surrounding the scope of the abuse of law doctrine.

Some other procedural law guarantees may be pointed out as defence arguments by taxpayers, such as some based on the right to be heard.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The abuse of law doctrine is often put forward by the Italian tax authorities in recent assessments and/or discussions.

Can a criminal prosecution follow ?

Although a criminal law prosecution might also be initiated in cases of abuse of law, many scholars argue that it is rather difficult for public prosecutors to demonstrate the fraudulent intent of the relevant taxpayer, which is necessary to establish criminal liability.

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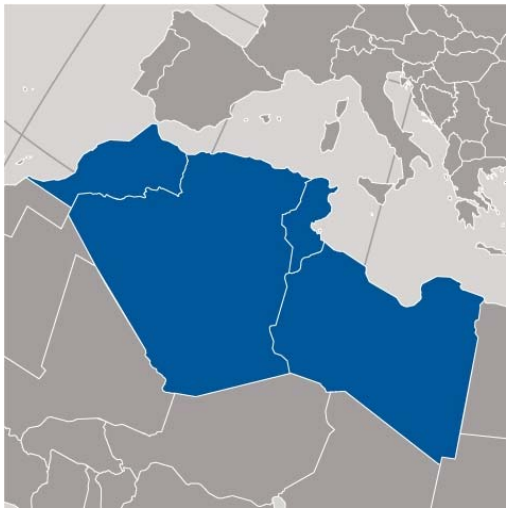

Maghreb

Abuse of law

Algeria

The concept of abuse of law is not specifically defined by Algerian tax law.

However, abuse of law is defined by civil law in Article 124 bis of the Civil Code. This article provides that the abusive exercise of a right is an offence, in particular in the following cases:

- objective to cause harm to a third party;
- objective to fulfil an interest with minimal significance compared to the resulting loss sustained by a third party;
- objective to fulfil an illegal interest.

However, this definition does not seem to be extended to tax matters.

The Algerian tax authorities have never really applied the concept of abuse of law in relation to misconduct by taxpayers and, in particular, with regard to tax optimization in the scope of tax treaties.

Nevertheless, although the concept of abuse of law does not exist strictly speaking with regard to taxation, the notion of fraud is recognised and precisely defined (unlike under French law) by Algerian tax law .

This notion of fraud mainly covers:

- concealment or attempted concealment by any person of sums or income on which VAT is payable and, in particular, sales without an invoice;
- any action, practice or conduct implying a manifest intent to avoid or delay the payment of any taxes based on the tax returns filed.

Abuse of law in **Algeria** and in **Morocco**

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Morocco

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

We draw your attention to the fact that strictly speaking no concept of "abuse of law" exists in Moroccan law.

Nevertheless, in practice, it appears that the tax authorities can apply similar rules in order to give to the real qualification to an act qualified as an abuse.

Moreover, the possibility of implementing innovative schemes may be limited by other regulations in force in Morocco (e.g. the existence of an exchange control regulation requires compliance with specific rules in order to avoid any risk of a cash trap).

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

As set forth above, the concept of "abuse of law" is not applicable in Morocco. As a result, no reference is made to EU case law (as the Kingdom of Morocco is not in the EU). The concept of "beneficial ownership" does not exist.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

The concept of "substance over form" is generally not applied in Morocco, as the double tax treaties concluded by the Kingdom of Morocco are quite similar.

A notable exception existed regarding the double tax treaty concluded with Sweden, but it is no longer applicable since January 1st, 2008.

4. What penalties/sanctions apply? What defences are available to taxpayers?

The penalties in case of tax reassessment are as follows:

- Penalties of 15% for failure to submit a tax return (100% in case of bad faith or dissimulation by the taxpayer);
- Penalties of 10% for non-payment;
- Interests for late payment of 5% the first month and 0.5% the subsequent months.

Moreover, in application of Article 187 of the General Tax Code, a fine equal to 100% of the amount of the tax avoided is applicable in case of fraud for the consultant or the adviser of the taxpayer, irrespective of any potential disciplinary action if the latter exercises a public office.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The concept of abuse of law (which is not strictly speaking applicable in Morocco) does not entail any criminal liability

Moreover, the tax authorities will not use this kind of threat (using other concepts in order to achieve a similar outcome).

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Netherlands

Abuse of law

1. Is there a so-called concept of “abuse of law” in your case law/tax system?

The Netherlands has a concept of abuse of law.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

It is based on case law, which is quite elaborate in this respect. It is noted that there is one specific rule under Dutch tax law relating to a general abuse of law, but this rule is not applied in practice. In addition, there is one specific rule denying the benefits of a reduced withholding tax on dividends in some very specific cases. In practice, this rule applies relatively rarely.

EU case law is not particularly taken into account in this respect.

There is not much case law regarding the meaning of beneficial ownership. As a general rule, a wide view of the meaning of beneficial ownership is adopted in the Netherlands.

‘Abuse of law in the Netherlands’

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

The abuse of law concept is not applied or perceived in a different way in international situations compared to purely domestic situations.

As for the notion of substance, although it is difficult to draw general conclusions from case law, it seems that courts do not require much substance in order for a company to successfully claim residency in a particular country. They mainly look at the Board of Directors' and the place where they take (formal) decisions, which does not require much substance. Substance does not seem to be much of an issue in practice.

It must be noted that the Dutch tax authorities have issued guidelines stating that a certain level of substance is required for Dutch holding companies in the event where a ruling is requested confirming the tax treatment in a specific case. Some Dutch tax practitioners see these guidelines as minimum requirements for holding companies in general regardless of whether a ruling is requested, but in our view that this approach is generally speaking too prudent and is not backed up by any rule in law or case law. Every situation needs to be looked at taking into account its specific aspects. In our opinion, it goes too far to argue that the substance factors laid down in the above-mentioned guidelines always need to be followed.

4. What penalties/sanctions apply? What defences are available to taxpayers?

Abuse of law usually leads to the denial of the tax advantage that was envisaged by the taxpayer. Whether and what penalties and/or additional sanctions can be applied very much depend on the facts and circumstances of each case. It is not uncommon for no penalties to be imposed in an abuse of law case (apart from the tax advantage that is withdrawn), as it quite often relates to a situation which is not explicitly prohibited under the strict interpretation of the law.

In terms of possible defence arguments, the discussion regarding whether an abuse of law should lead to the denial of the tax advantage in a specific case basically relates to the interpretation of the law. It is not so much a question of having or finding defence arguments but the way in which the law should be interpreted and what the law intends to achieve (and whether the transaction is allowed under that interpretation).

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The abuse of law concept is used from time to time, although it cannot be said to be used regularly. When applied, it is usually applied retroactively, i.e., in court proceedings after a certain tax-motivated transaction has taken place, which the tax authorities want to challenge.

Abuse of law is usually applied to situations where there is a difference in the interpretation and application of the rules as laid down by tax law. It usually does not relate to criminal cases so it is not usually followed by criminal prosecution.

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Poland

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

The concept of "abuse of law" exists in the Polish tax system.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

According to the Tax Ordinance, the tax authorities can, in the scope of the analysis of the tax implications of a given transaction, take into account the parties mutual intentions and the purpose of the transaction rather than simply the literal wording of the agreement between the parties. A simple example: the parties entitled a signed agreement a lease agreement, but it was in fact a sale agreement. In this case, the tax authorities would derive the tax consequences from a sale agreement. Moreover, if the parties, when carrying out a transaction for the sake of appearances, hid another transaction, the tax authorities could derive the tax implications from the hidden transaction.

‘Abuse of law in Poland’

There is no explicit general anti-abuse clause whereby the tax authorities are allowed to disregard a transaction only on the grounds that no other significant results can be expected from the transaction than the reduction of tax liability or the increase of a loss. an the amount of overpaid tax or the amount of the tax refund. However, under the Corporate Income Tax Act, in accordance with Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, the tax authorities can refuse the tax neutrality of a merger or division of companies when the merger or division is not carried out for an economically justified reason, but the main objective or one of the principal objectives of such transaction is to avoid or evade taxation.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

In principal, there is no difference between the perception of the concept of "abuse of law" in domestic situations and international situations. The notion of "substance" in situations where holding companies are involved is not well recognised by the tax authorities and courts. However, the Corporate Income Tax Act provides that a company is resident for tax purposes as long as it has a registered office in Poland and/or if the place of effective management is located in Poland. In the case of "substance" requirements to apply relief from withholding tax on payments made to other States, the Polish tax authorities rely on tax certificates issued by the tax authorities of recipients of the payments.

4. What penalties/sanctions apply? What defences are available to taxpayers?

There are no specific penalties/sanctions to the situation of "abuse of law" that are different from those applied to the situation where taxpayers reduce tax liability.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The tax authorities do not often use the general anti-abuse clause provided in the Tax Ordinance. Criminal prosecution may follow depending of what kind of infringement was committed.

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Russia

Abuse of law

1. Is there a so-called concept of “abuse of law” in your case law/tax system?

The domestic tax statutes do not recognize the concept of “abuse of law”, per se. However, the concept is currently evolving as part of the tax authorities’ case and clarification letters of the tax administration.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

The two elements of the abuse of law concept in Russia are as follows.

1. The view of the transaction based on “substance-over-form” and “business purposes” principles.

2. For the application of treaty benefits the recipient must be a “beneficial owner” of income. The Russian tax administration authorities classifies “beneficial owner” as a taxpayer, which who (a) has a right to receive income under legal instrument (contract, participation, etc.) and (b) is free to determine the received income’s economic destiny purpose (is free to retain or dispose -off, etc. the such income).

‘Abuse of law in Russia’

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

The Russian tax authorities use notion the concept of "substance over form" vis-à-vis the substance of particular transaction and substance of operations of the holding company abroad. For With regard to the substance of a transaction, the tax authorities check whether the economic substance corresponds to the form of the transaction. For example, there might be the case where interest or royalties (0% withholding under most treaties) paid abroad will be treated as economically unjustified as they contradict the underlying substance of the transaction. As a result, they might be re-qualified according to their actual substance, for example into as dividend distributions of dividends (which are taxed at source).

4. What penalties/sanctions apply? What defences are available to taxpayers?

The penalties are same as in the case of non-payment or underpayment of tax. If the facts of treaty-shopping, abuse of law, incoherence between the form and substance of the transaction or use of foreign conduit companies is are established – then the transaction is re-qualified according to the views opinion of the tax service authorities and the re-calculation of the taxable base follows. If it results in underpayment of the tax, then the fine is charged (20% or 40% of the underpaid amount) and the penalty accrues. The penalty represents an interest, which accrues for each day of delinquency inlate payment of the underpaid amount of tax. It is calculated on the basis of 1/300 of the Russian Central Bank's interest rate (currently 11.5%) charged for each day of delinquencylate payment.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The threat exists, but in practise, the tax authorities do not use it regurlarly. Usually, the prosecution is initiated by tax officials, where in the tax authorities'opinion, no right to apply a preferential 5% withholding tax existed under the treaty (or 0% for interest and royalties). Usually, these challenges are based on technical breaches (such as absence of certificates of residence in relation to foreign recipients' income, etc.). In the scope of these investigations, abuse of law or treaty-shopping arguments might arise.

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Spain

Abuse of law

1. Is there a so-called concept of "abuse of law" in your case law/tax system?

The Spanish tax authorities are able to challenge a whole transaction by observing the so-called abuse of law procedure established by the applicable Spanish regulations. In other words, they would argue that the transaction was implemented solely for the purpose of avoiding Spanish taxation.

In general terms, the concept of abuse of law is deemed to exist when the taxpayer carries out a legal transaction and applies a tax provision in such a way as to avoid the payment of the corresponding tax.

Apart from this, some general anti-avoidance provisions are included in the laws that regulate specific taxes.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

The concept of abuse of law is included in the Spanish General Taxation Act and it mainly relates to the interpretation of tax rules.

Under current law, the concept of abuse of law is included in two articles and concepts:

- **The so-called "conflict with the application of tax provisions"** which is deemed to exist when (i) the taxable event is totally or partially avoided, or (ii) the taxable base or the tax due is reduced by actions or transactions which meet the following requirements:

1. They are notoriously artificial or inappropriate for achieving the results obtained, either individually or when considered as a whole.

Abuse of law in Spain

2. By implementing them, no relevant economic or legal effects are achieved other than (i) tax savings, and (ii) the effects which would have been obtained through the usual and proper acts or business.

In order to declare the conflict with the application of tax provisions, the tax authorities need a positive previous report by a special commission created for such purpose.

No penalties apply to the adjustments charged as a result of this procedure but late payment interest would be imposed.

- **The concept of "simulation or sham transaction".** Article 16 of the Spanish General Taxation Act refers to "simulation or sham transactions or acts". In relation to these situations, the Act establishes that the taxable event would correspond to the event that had been tried to be avoided.

Penalties and late payment interest would be charged on the transactions considered to be simulated.

Apart from the general concept included in the Spanish General Taxation Act, there are some anti-avoidance provisions included in various specific laws. Please find below some of the most important anti-avoidance provisions as examples:

- **The Spanish special tax neutrality regime** laid down by the Spanish CIT Act, which basically follows the EU 90/434 Merger Directive. In particular, this special tax regime allows for the tax neutrality of mergers, spin-offs, exchanges of shares and contributions in kind of business activities and other special contributions in kind.

However, Article 96 of the Spanish CIT Act establishes that the regime could be rejected by the Spanish tax authorities when the transaction has mainly been carried out for the purpose of fraud or tax evasion. The transactions implemented have to be based on valid business reasons (i.e. restructuring activities), which means that they must be supported by business/economic reasons and not only tax reasons.

- **Dividend distributions from a Spanish company to EU resident entities** would benefit from the provisions of the Parent-Subsidiary Directive (as implemented in Spain) according to which no Spanish withholding tax would apply after a holding period of 12 months. In order to apply this withholding tax exemption, the following conditions should be met: (i) both parent and subsidiary should be subject to tax entities, included in Annex of EU Directive 90/435/CEE (as revised by EU Directive 2003/123/CE), (ii) the parent should hold a stake of at least 10% in the share capital of the subsidiary and (iii) the majority of the voting rights in the parent should ultimately be held by EU residents (otherwise, it should be demonstrated that (i) the parent conducts an entrepreneurial activity similar to the subsidiary's activity, or (ii) the parent will manage and control the participation in the subsidiary through the corresponding provision of human and material resources or (iii) that the parent has been incorporated for valid economic reasons and not simply to obtain the benefits of this provision). The last requirement is an anti-avoidance provision established in the Non-Residents Income Tax Act.

Is EU case law taken into consideration in any way?

From a theoretical point of view, EU case law should have direct applicability in Spain and even in certain cases prevail over Spanish internal law.

Nevertheless, it is difficult in practice to ensure that the Spanish Courts accept EU case law, most of the time due to the lack of similarity between the situations under consideration and also due to the differences existing between taxes among different states.

Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

We should say that Spanish tax authorities and Courts take a wide meaning of "beneficial ownership". According to this, they could try to challenge some structures due to the fact that the entity receiving the payments for example is not the beneficial owner, or deny the application of some double tax treaty provisions due to the same fact.

In any case, it is important to point out that Spanish law does not differentiate between legal and beneficiary ownership. Therefore, cases, where under other countries' law there is such a split, must be taken very carefully from a Spanish tax point of view as there is a great uncertainty as to how these cases should be treated or how a court would view the situation.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

As regards this issue and in order to understand the position of the tax authorities and courts, it is interesting to mention a recent Spanish National Court's decision of 22 January 2009 (case number 59/2005) according to which the Court denies the exemption from withholding tax on dividends distributed by a Spanish subsidiary to its US parent company via Dutch interposed holding companies.

The Spanish National Court has followed the same arguments used by the Spanish Administrative Court to deny the application of the Parent-Subsidiary Directive 90/435/EEC rules to dividends distributed by the Spanish subsidiary to its Dutch parent company. In this respect, according to the National Court, the domestic anti-avoidance provisions regarding the exemption from withholding taxes under the Directive are fully applicable because:

- the Dutch parent should be regarded as a mere conduit company between the US and Spain as very little improvement is added by the Dutch parent to the R&D activities carried out in the US and the production plants in Europe;

- even though the Spanish subsidiary showed evidence that between 10 and 19 employees worked for the Dutch company during the taxable years in the case at hand, the National Court disregarded this element and considered it irrelevant as the Spanish subsidiary's accounting records and management-related documents were kept at the Spanish subsidiary's premises; and

- no business purposes could be found when the parent company, which was incorporated in Ireland, transferred its residence from Bermuda to the Netherlands. In addition, there was a lack of management support provided by the Dutch parent to the Spanish subsidiary.

According to the Spanish Administrative Court, the National Court concluded that the exemption from withholding taxes on the distribution by Spanish subsidiary to the Dutch parent was not applicable. Therefore, a 5% withholding tax should be imposed in Spain according to the Dutch-Spanish tax treaty.

4. What penalties/sanctions apply? What defences are available to taxpayers?

Penalties should only be applied in the event of "simulation or sham transactions" but not in the event of a conflict with the application of tax provisions. Penalties applicable in the event of simulated transactions could range from a minimum of 50% of the tax due and a maximum of 150% of the tax due. Please note that in some cases "simulation or sham transaction" can be understood to constitute criminal conduct.

Apart from the obvious ways of defending a taxpayer, as regards available defences, it is possible to ask for tax rulings which are binding on the Spanish tax authorities.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The Spanish tax authorities used "simulation" to threaten taxpayers. Given the difficulties in practice of the "conflict with the application of tax provisions" procedure, the Spanish tax authorities try to apply the "simulation or sham transactions" concept, which has been used lately with certain regularity.

It is important to remember that "simulation or sham transactions" could result in criminal prosecution called tax fraud in the event where the tax due exceeds €120,000.

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Switzerland

Abuse of law

1. Is there a so-called concept of “abuse of law” in your case law/tax system?

Yes. The principle of non-protection of abuse of law (Rechtsmissbrauch) was originally introduced into the Swiss legal system by Article 2, paragraph 2 of the Swiss Civil Code (Schweizerisches Zivilgesetzbuch) in 1907.The concept of abuse of law has subsequently increasingly spread to other areas of the Swiss legal system and also became an important pillar of Swiss domestic and international tax law under the concept of tax avoidance (Steuerumgehung).

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

Based on the case law of the Federal Supreme Court (Schweizerisches Bundesgericht), a transaction or a legal structure may be disregarded for tax purposes under the following conditions:

1. the legal structure used by the taxpayer is abnormal or artificial and has no commercial justification, and

2. tax considerations are deemed to be the only grounds for the transaction/structure, and the transaction/structure results in significant tax savings for the taxpayer.

In the area of Swiss treaty law, specific anti-abuse provisions apply.

In cases where a Swiss resident company collects treaty-favoured income, specific unilateral anti-abuse provisions apply. The corresponding Federal Decree on Measures Against the Improper Use of Tax Treaties concluded by the Swiss Confederation (Bundesratsbeschluss betreffend Massnahmen gegen die ungerechtfertigte Inanspruchnahme von Doppelbesteuerungsabkommen des Bundes) was enacted by the Federal Council (Bundesrat) in 1962.

‘Abuse of law in Switzerland’

Before the implementation of the 1962 Abuse Decree, Swiss companies were frequently used in order to benefit from a combination of a favourable treaty network and interesting cantonal tax privileges on the one hand and, the possibility to pass on treaty-favoured income to non-resident beneficiaries habitually domiciled in non-treaty jurisdictions without triggering Swiss source taxes, on the other hand. As a result of significant pressure from contracting States, Switzerland decided to avoid these situations by implementing the 1962 Abuse Decree.

In cases where a foreign resident company applies for relief under a Swiss double tax treaty, the Swiss tax authorities closely examine whether the foreign resident company abusively applies for the double tax treaty benefits. This close examination not only takes place in cases where a double tax treaty with an explicit anti-abuse clause is applied (e.g. double tax treaties with the Netherlands, UK and US) but also in cases where the applicable double tax treaty does not contain an anti-abuse clause (e.g. double tax treaty with Luxemburg). The legal basis of this extra-conventional anti-abuse clause is not entirely clear. The Federal Supreme Court held in a leading case that a general anti-abuse provision is implied by the principle of good faith as set forth in Articles 26 and 31 of the Vienna Convention on the Law of Treaties. In other cases, the federal tax administration bases the anti-abuse test on a narrow interpretation of beneficial ownership.

Is EU case law taken into consideration in any way?

EU case law is in principle not applicable to Switzerland. Although Article 15 of the Swiss-EU Taxation on Savings Agreement is based on the EC Parent-Subsidiary Directive, the federal tax administration does not refer to EU case law when interpreting this provision.

Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

As already mentioned above, the Swiss tax authorities and tax courts take a narrow view of the meaning of beneficial ownership. In cases where the applicable double tax treaty does not provide for explicit anti-abuse rules, the federal tax administration bases any kind of anti-abuse test on this term.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

In this context, the 1962 Abuse Decree lists four basic scenarios under which the applied tax relief might be considered to be abusive for Swiss resident companies applying for treaty benefits:

1. abusive transfer of income to persons who are not entitled to claim the treaty benefits in question;

2. inappropriate (too conservative) profit distributions;

3. use of fiduciary relationships;

4. foreign-controlled family foundations or partnerships.

If a foreign resident company applies for relief under a Swiss double tax treaty, the federal tax administration habitually takes a broad view and do not focus on only one criterion such as substance. In order to determine whether the relationship between the Swiss distributing company and its foreign shareholder is based on an economic justification, the federal tax administration submits a long list of questions and information requests. This list is also comprised of questions dealing with substance issues such as the number and position of employees and existence of office premises.

4. What penalties/sanctions apply? What defences are available to taxpayers?

The main sanction applied is usually that the transaction or structure considered to be abusive is disregarded for tax purposes by the tax administration. It is very often difficult to precisely predict the tax consequences when the tax administration qualifies a structure as abusive. In cases of treaty abuse, the treaty relief is reduced either to a partial or full refusal of a specific treaty benefit.

If the shares of a Swiss company are transferred from a person who is resident in a country which does not have a double tax treaty with Switzerland to a shareholder who is resident either in Switzerland or in a country which has a double tax treaty with Switzerland, treaty relief under this double tax treaty is very often refused on any available reserves existing at the time of the share transfer (Altersreservenpraxis).

It is possible, and very often also advisable, to obtain an advance ruling from the Swiss federal tax administration before establishing a structure or executing a transaction which could be qualified as abusive. Whereas the tax ruling procedure in purely domestic cases usually taxes two to four weeks, it takes significantly longer to obtain a tax ruling confirming the absence of treaty abuse in an international context.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

Tax avoidance is regularly discussed with the tax authorities as part of an advance tax ruling procedure. As tax avoidance is not illegal (as opposed to tax evasion), an abusive structure does not trigger any criminal liability. However, tax consequences may result in the form of additional taxes, which were initially avoided by the abusive structure or transaction.

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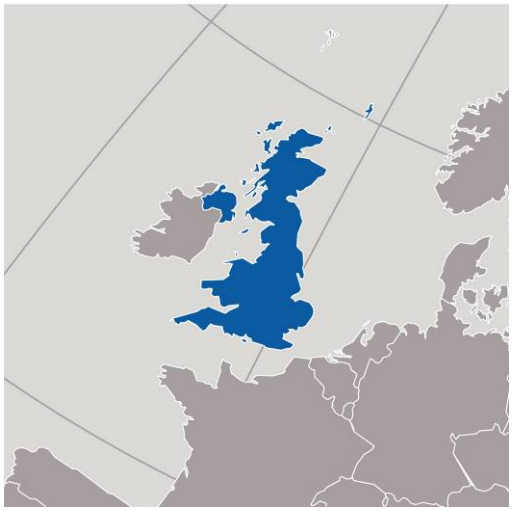

United Kingdom

Abuse of law

1. Is there a so-called concept of “abuse of law” in your case law/tax system?

There is no general anti-avoidance test which applies across UK tax law generally however, there is a long standing line of cases in which the UK judiciary have developed an anti-avoidance doctrine. In broad terms this doctrine (often referred to as the Ramsay principle after one of the cases) is effectively the UK equivalent of abus de droit. There are also a number of specific instances in the UK legislation where parliament have enacted general anti-avoidance provisions, but this is more usually dealt with in the UK law by specific targeted legislative provisions which sometimes include a motive or genuine commercial purposes test.

2. How is this concept implemented? Is EU case law taken into consideration in any way? Do your tax authorities/courts take a narrow or wide view of the meaning of "beneficial ownership"?

Where the legislation contains a motive test, the courts are asked to decide as a question of fact whether the legislative test has been passed. Questions of substance will often be relevant to cases like these. In the absence of such a test, the courts are asked to apply the general anti-avoidance principle mentioned above. There is no certainty about the outcome in many avoidance cases although the recent trend appears to have been against the taxpayer. The UK courts will consider EU case law in a VAT context. Because the UK anti-avoidance case-law is quite well developed, and because the avoidance cases outside of the VAT context generally concern domestic provisions, they do not generally feel the need to formally refer to the EU abus de droit case law where VAT is not at issue. The influence of the ECJ can sometimes be discerned in some judgements/reasoning however. Following the Indofood decision the UK authorities issued a statement distinguishing between the so called domestic (narrow) and international (wide) meaning of beneficial ownership. It is clear from their statement that they will use the so called

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international approach to beneficial ownership where they perceive there to be tax avoidance, so in many ways the UK approach to beneficial ownership is simply a subset of the general approach to interpreting legislation, which is to say that the authorities will take a wide 'purposive' approach when it suits them to do so.

3. How is the concept of "abuse of law" perceived where the facts relate to international matters (as opposed to purely domestic situations)? Specifically, how do the tax authorities and Courts deal with the notion of "substance" (i.e. in situations where holding companies are involved)?

To the extent that they are asked to rule on English law, the UK courts take the same approach whether the case concerns purely local entities or whether there are international elements. An EU matter where discrimination is argued but where anti-avoidance is offered as a justification would normally be referred to the ECJ. In relation to holding companies, the UK authorities might seek to apply their flexible definition of beneficial ownership if they perceive there to be tax avoidance. The question of what constitutes sufficient substance largely depends on the context. Recent cases regarding corporate and individual residence have produced conflicting decisions and it can be argued that the ECJ approach to substance in Halifax is less strict than the UK approach in some cases. The case law on this issue is still evolving.

4. What penalties/sanctions apply? What defences are available to taxpayers?

The penalties depend on the particular tax at stake, the amounts of tax and the justification. In many cases the penalty can be as much as the original tax at stake plus interest. In cases of avoidance rather than evasion (not always an easy distinction) penalties should not generally include criminal sanctions. In avoidance cases, the taxpayer normally relies upon the strict wording of the legislation, the taxpayer's or entity's commercial purpose or an element of genuine uncertainty about events or steps which might otherwise appear pre-ordained. Taxpayers will often elect to disclose details of planning to the UK authorities in order to restrict the authorities' enquiry window or to reduce the risk of penalties. Insurance, although not strictly a 'defence' is commonly used in the UK to hedge the risk of certain planning being ruled to be abusive.

5. Is the concept of "abuse of law" regularly used by the tax authorities to threaten taxpayers? Can criminal prosecution follow?

The UK authorities will often raise tax avoidance as a potential line of attack if they perceive a transaction to be abusive. Criminal sanctions are normally restricted to cases of evasion rather than avoidance, so if a taxpayer has a 'filing position' i.e. a reasonable argument that the transaction should be taxed as planned, criminal penalties would not normally be appropriate. The tax authorities frequently appear to elide tax avoidance and tax evasion however, so care must be taken to establish the parameters of the dispute as early as possible where tax evasion is mentioned.

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